

Q1: Go to internet and find what the following terms mean: yield, preferred stock, convertible bond, credit default swap, stock option.

Q2: Read "Corporate debt: CEOs' conundrum" (Financial Time, August 7, 2011; in the CMR) and make sense of figures in paragraphs 2 and 3.

Q3: Read "FRB survey of consumer finances" (in the CMR) and construct (try your best) the balance sheet of the median US family of the top 10% by wealth.

Q4: Read "AIG set to sue BofA for \$10.5bn" (in the CMR). Why does the shareprice of Bank of American drop so much? Does the price of its debt drop as much? Think more generally why shareprices are so sensitive to news. If you want to make profit out of news, which kind of firms's shares should you focus on? High leveraged or low leveraged?

Q5: Consider a single period binomial setting where the riskless interest rate is zero (so the discount rate is 1) and everyone is risk neutral. A firm produces cash flows of \$ 210 if the economy is good and \$ 80 if the economy is bad. The good and bad states occur with equal probability. Initially, the firm has 100 shares outstanding and debt with a face value of \$50 due at the end of the period.

Suppose the firm above unexpectedly announces that it will issue additional debt, with the same seniority as existing debt and a face value \$50. *The firm will use the entire proceeds to repurchase some of the outstanding shares.*

(i) What is the market price of the new debt? What is the effect on the old debt?

(ii) Just after the announcement, what will the price of a share jump to? How many outstanding shares will be repurchased?